

Business Organizations

Economics & You



Do you work at a business? Belong to a church? Participate in a club? Chances are these institutions play a significant role in your life. To learn more about how business organizations and economic institutions operate, view the Chapter 4 video lesson:

Business Organizations



Chapter Overview Visit the *Economics: Principles and Practices* Web site at tx.epp.glencoe.com and click on *Chapter 3—Chapter Overviews* to preview chapter information.

CLICK HERE

Running a business involves risks as well as expectations.

CONTENTS

Forms of Business Organization

Study Guide

Main Idea

Businesses may be organized as individual proprietorships, partnerships, or corporations.

Reading Strategy

Graphic Organizer As you read about business organizations, complete a graphic organizer similar to the one below to explain how the three types of business organizations differ from one another.

Proprietorships	
Partnerships	
Corporations	

Key Terms

sole proprietorship, proprietorship, unlimited liability, inventory, limited life, partnership, limited partnership,

bankruptcy, corporation, charter, stock, stockholder, shareholder, dividend, bond, principal, interest, double taxation

Objectives

After studying this section, you will be able to:

1. **Describe** the characteristics of the sole proprietorship.
2. **Understand** the advantages and disadvantages of the partnership.
3. **Describe** the structure and features of the corporation.

Applying Economic Concepts

Unlimited Liability Some forms of business organization can leave you holding the bag—including all the bills—for the entire business. Read to see how personal liability is affected by the type of business owned.

Cover Story

Raw Feelings

Scott Melton thinks he got a raw deal. Melton, who recently opened Sushi Nights on Main Street in Deep Ellum [Texas], filed for Chapter 11 bankruptcy in April for Sushi Deep Ellum Inc., the general partnership he formed to operate Deep Sushi. . . . Last June, Deep Sushi's limited partners, a group of 10 or so anesthesiologists and other human meat menders, gave Melton the boot. Not only that, they stiffed him, he says. "They left me holding the bag for \$57,000 worth of unpaid taxes . . . including utilities and vendor bills. . . ."



Mounting bills are one of the risks of business.

—Dallas Observer Online, May 20–26, 1999

There are three main forms of business organizations in the economy today—the sole proprietorship, the partnership like the one Scott Melton describes in the cover story, and the corporation. Each offers its owners significant advantages and disadvantages.

Sole Proprietorships

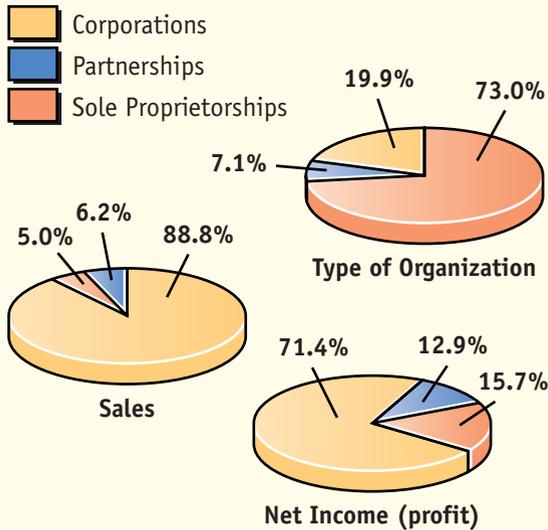
The most common form of business organization in the United States is the **sole proprietorship** or **proprietorship**—a business owned and run by one person. Although relatively the most numerous and profitable of all business organizations, proprietorships are the smallest in size. As **Figure 3.1** on page 58 shows, proprietorships earn almost one-fifth of the net income earned by all businesses, even though they make only a fraction of total sales.

Forming a Proprietorship

The sole proprietorship is the easiest form of business to start because it involves almost no requirements except for occasional business

Figure 3.1

Corporations, Partnerships, and Sole Proprietorships



Source: 2000 Statistical Abstract of the United States

Using Graphs Businesses can be organized in the United States in a number of ways.

Which business organization accounts for the largest amount of sales?



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licenses and fees. Most proprietorships are ready for business as soon as they set up operations. You could start a proprietorship simply by putting up a lemonade stand in your front yard. Someone else might decide to mow lawns, do gardening, or open a restaurant. A proprietorship can be run on the Internet, out of a garage, or from an office in a professional building.

Advantages

The first advantage of a sole proprietorship is the ease of starting up. If someone has an idea or an opportunity to make a profit, he or she has only to decide to go into business and then do it.

The second advantage is the relative ease of management. Decisions may be made quickly, without having to consult a co-owner, boss, or “higher-up.” This flexibility means that the owner can make an immediate decision if a problem comes up.

A third advantage is that the owner enjoys the profits of successful management without having to share them with other owners. The possibility of suffering a loss exists, but the lure of profits makes people willing to take risks.

Fourth, the proprietorship does not have to pay separate business income taxes because the business is not recognized as a separate legal entity. The owner still must pay individual income taxes on profits taken from the sole proprietorship, but the business itself is exempt from any tax on income.

Suppose, for example, Mr. Winters owns and operates a small hardware store in a local shopping center and a small auto repair business in his garage next to his home. Because neither business depends on the other, and because the only thing they have in common is ownership, the two businesses appear as separate and distinct economic activities. For tax purposes, however, everything is lumped together at the end of the year. When Mr. Winters files his personal income taxes, the profits from each business, along with wages and salaries earned from other sources, are combined. He does not pay taxes on each of the businesses separately.

A fifth advantage of the proprietorship is the psychological satisfaction. Some people want the personal satisfaction of being their own boss. Other people have a strong desire to see their name in print, have dreams of great wealth or community status, or want to make their mark in history.

A sixth advantage is the ease of getting out of business. In this case, all the proprietor has to do is pay any outstanding bills and then stop offering goods or services for sale.

Disadvantages

One main disadvantage of a proprietorship is that the owner has **unlimited liability**. This means that the owner is personally and fully responsible for all losses and debts of the business. If the business fails, the owner’s personal possessions may be taken away to satisfy business debts.

Business Organizations



Sole Proprietorships The sole proprietorship is the most common form of business organization. *What are some of the reasons for setting up a sole proprietorship?*

To illustrate, consider the earlier case of Mr. Winters who owns and operates two businesses. If the hardware business should fail, Mr. Winters' personal wealth, which includes the automobile repair shop, may be legally taken away to pay off debts arising from the hardware store.

A second disadvantage of a proprietorship is the difficulty in raising financial capital. Generally, a great deal of money is needed to set up a business, and even more is required to support its expansion. A problem may arise because the personal financial resources available to most sole proprietors are limited. Banks and other lenders usually do not want to lend money to new or very small businesses. As a result, the proprietor often has to raise financial capital by tapping savings, using credit cards, or borrowing from family members.

A third disadvantage of a proprietorship is that of size and efficiency. A retail store, for example, may need to hire a minimum number of employees just to stay open during normal business hours. It may also need to carry a minimum **inventory**—a stock of finished goods and parts in reserve—to satisfy customers or to keep production flowing smoothly. Because of limited capital, the proprietor may not be able to hire enough personnel or stock enough inventory to operate the business efficiently.

A fourth disadvantage is that the proprietor often has limited managerial experience. The owner-manager of a small company may be an inventor who is highly qualified as an engineer, but lacks the “business sense” or time to oversee the orderly growth of the company. This owner may have to hire others to do the types of work—sales, marketing, and accounting—that he or she cannot do.

A fifth disadvantage is the difficulty of attracting qualified employees. Because proprietorships tend to be small, employees often have to be skilled in several areas. In addition, many top high school and college graduates are more likely to be attracted to positions with larger, well-established firms than small ones. This is especially true when larger firms offer *fringe benefits*—employee benefits such as paid vacations, sick leave, retirement, and health or medical insurance—in addition to wages and salaries.

A sixth disadvantage of the sole proprietorship is **limited life**. This means that the firm legally ceases to exist when the owner dies, quits, or sells the business.

STANDARD & POOR'S INFOBYTE

Business Inventories The Business Inventories report measures the monthly percentage changes in inventories from manufacturers, retailers, and wholesalers. The report is useful in predicting inventories within the gross domestic product (GDP), which can be volatile from quarter to quarter. Business inventories are reported monthly by the Commerce Department. Business inventories data, released in the third week of each month, show the monthly percentage change in inventories from manufacturers, retailers, and wholesalers. Because the majority of the data is old by the time it is released, it is usually not a key report to the markets. One portion of the report that does draw a bit of attention, though, is the inventory-to-sales ratio. This particular component is useful in forecasting, since increasing inventory-to-sales ratios signals a cutback in production.

Partnerships

 A **partnership** is a business jointly owned by two or more persons. It shares many of the same strengths and weaknesses of a sole proprietorship. As shown in **Figure 3.1**, partnerships are the least numerous form of business organization, accounting for the smallest proportion of sales and net income.

Types of Partnerships

The most common form of partnership is a *general* partnership, one in which all partners are responsible for the management and financial obligations of the business. In a *limited* partnership, at least one partner is not active in the daily running of the business, although he or she may have contributed funds to finance the operation.

Forming a Partnership

Like a proprietorship, a partnership is relatively easy to start. Because more than one owner is involved, formal legal papers called articles of partnership are usually drawn up to specify arrangements between partners. Although not always required, these papers state ahead of time how profits (or losses) will be divided.

The articles of partnership may specify that the profits be divided equally or by any other arrangement suitable to the partners. They also may state the way future partners can be taken into the business and the way the property of the business will be distributed if the partnership ends. Individuals who join as partners must be very careful because they are financially responsible for personal as well as business debts of their partners (except for those debts specifically exempted in the partnership contract).

CYBERNOMICS SPOTLIGHT

Entrepreneurs of the New Economy

During the 1700s and 1800s, a series of innovations in agriculture and industry led to profound economic and social change throughout many regions of the world. Urban industrial economies emerged in these areas and eventually spread around the world. This transformation, which became known as the Industrial Revolution, began when power-driven machinery in factories replaced work done in homes, altering the way people had lived and worked for hundreds of years.

In the late twentieth century, the world underwent a technological revolution as significant as the Industrial Revolution. Computers and the Internet are at the heart of this transformation.

Dell Computer Few have done more to take advantage of the promise of the Internet than Michael Dell. Under his leadership Dell Computer is in the forefront of making the Web the foundation of an existing business. Many producers, like Dell, are bypassing regular channels

of trade and reaching out to their customers directly. Dell Computer grew twice as fast as other personal computer manufacturers by allowing buyers to configure their own PCs online.

Another reason for Dell's success is velocity. According to Dell, business velocity is shrinking time and distance between a company and its suppliers as well as its customers. "The reduction of time, the reduction of inventory, and the reduction of physical materials and assets can drive a tremendous improvement in business efficiency," notes Dell. "Customers' purchasing decisions become faster and they have direct access to information they need immediately. Customers can compare products around the world over the Internet. This has dramatic implications for companies that previously had based their strategies on having a physical location, and having customers go and buy their products."



Michael Dell

Advantages

Like the sole proprietorship, the first advantage of the partnership is its ease of establishment. Even the costs of the partnership articles, which normally involve attorney fees and a filing fee for the state, are minimal if they are spread over several partners.

Ease of management is the second advantage. Generally, each partner brings different areas of expertise to the business: one might have a talent for marketing, another for production, another for bookkeeping and finance, and yet another for shipping and distribution. While partners usually agree ahead of time to consult with each other before making major decisions, partners generally have a great deal of freedom to make lesser ones.

A third advantage is the lack of special taxes on a partnership. As in a proprietorship, the partners withdraw profits from the firm and then pay individual

income taxes on them at the end of the year. Each partner has to submit a special schedule to the Internal Revenue Service detailing the profits from the partnership, but this is for informational purposes only and does not give a partnership any special legal status.

Fourth, partnerships can usually attract financial capital more easily than proprietorships. They are generally a little bigger and, if established, have a better chance at getting a bank loan. If money cannot be borrowed, the existing partners can always take in new partners who bring financial capital with them as part of their price for joining the business.

A fifth advantage of a partnership is the slightly larger size, which often makes for more efficient operations. In some areas, such as medicine and law, a

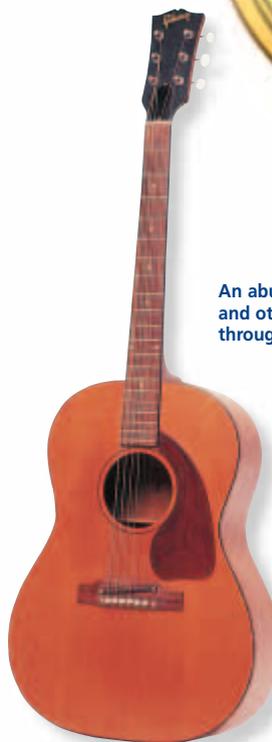
Did You Know?

Internet Commerce As use of the Internet spreads throughout the world, the U.S. share of Internet commerce will fall. In 2003, the United States will account for about 50% of Internet-based commerce, compared with about 75% in 1998.

Online Auctions The auction, a centuries-old tradition that links communities of buyers and sellers, is taking a new form on the Internet. One of the first to sell used goods online was the Gibson Guitar Company. The company offered older-model, used guitars for sale on the Web in 1996. Gibson's site was a huge success, in large part due to the celebrated reputation of its products.

The pioneer of person-to-person online trading is eBay. Launching its site in 1995, eBay at first offered only small collectibles such as Beanie Babies and Pez dispensers. Today, the company connects millions of buyers and sellers worldwide. It helps people buy and sell products in more than 1,000 categories, including antiques, books, collectibles, electronics, sports memorabilia, and toys.

Under the leadership of CEO Margaret Whitman, eBay helped establish negotiated pricing, a concept that influenced Web selling on items such as airplane tickets. The success of eBay has proven that customers will buy used merchandise online—a significant step for many businesses in accepting the idea of the online auction.



An abundance of collectibles and other goods are available through online auctions.

relatively small firm with three or four partners may be just the right size for the market. Other partnerships, such as accounting firms, may have hundreds of partners offering services throughout the United States.

A sixth advantage is that many partnerships find it easier to attract top talent into their organizations. Because most partnerships offer specialized services, top graduates seek out stable, well-paying firms to apply their recently acquired skills in law, accounting, and other fields.

Disadvantages

The main disadvantage of a general partnership is that each partner is fully responsible for the acts of all other partners. If one partner causes the firm to suffer a huge loss, each partner is fully and personally responsible for the loss. This is the same as

the unlimited liability feature of a sole proprietorship. It is more complicated, however, because more owners are involved. As a result, most people are extremely careful when they choose a business partner.

In the case of a **limited partnership**, the limited partners have limited liability. This means that the investor's responsibility for the debts of the business is limited by the size of his or her investment in the firm. If the business fails and large debts remain, the limited partner loses only his or her original investment, leaving the general partners to make up the rest.

Like the proprietorship, a partnership has limited life. When a partner dies or leaves, the partnership must be dissolved and reorganized. However, the new partnership may try to reach an agreement with the older partnership to keep its old name for public image purposes.

Another weakness is the potential for conflict between partners. Sometimes partners discover that they do not get along, and they either have to learn to work together or leave the business. If the partnership is large, it is fairly easy for these types of problems to develop, even though everyone thought they would get along well in the first place.

Partnerships offer entrepreneurs increased access to financial capital, but—as Scott Melton the former general partner of Deep Sushi found out—things do not always work out as planned. First, his business filed for **bankruptcy**, a court-granted permission to an individual or business to cease or delay debt payments. Then, because the limited partners had no liability beyond their initial investments, Scott was left with the rest of the bills. As a result, he also filed for bankruptcy.

Corporations

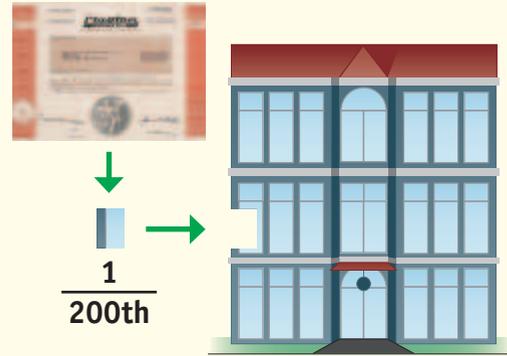
 As shown in **Figure 3.1**, corporations account for approximately one-fifth of the firms in the United States and about 90 percent of all sales. A **corporation** is a form of business organization recognized by law as a separate legal entity having all the rights of an individual. This status gives the corporation the right to buy and sell property, enter into legal contracts, and to sue and be sued.

Business Organizations



Partnerships Finding the right partner or partners is essential in a partnership. *What is the difference between a general partnership and a limited partnership?*

Stock Ownership



Making Comparisons If a corporation has a total of 200 shares of stock, and if you could somehow divide the firm into 200 equal parts, the owner of a single share of stock would own 1/200th of the corporation. A common stockholder, then, owns part of a company's plant and equipment and has a voice in how the business is managed. **How does common stock differ from preferred stock?**

Forming a Corporation

Unlike a sole proprietorship or partnership, a corporation is a very formal and legal arrangement. People who would like to *incorporate*, or form a corporation, must file for permission from the national government or the state where the business will have its headquarters. If approved, a **charter**—a government document that gives permission to create a corporation—is granted. The charter states the name of the company, address, purpose of business, and other features of the business.

The charter also specifies the number of shares of **stock**, or ownership certificates in the firm. These shares are sold to investors, called **stockholders** or **shareholders**. The money is then used to set up the corporation. If the corporation is profitable, it may eventually issue a **dividend**—a check representing a portion of the corporate earnings—to each stockholder.

Corporate Structure

When an investor purchases stock, he or she becomes an owner with certain ownership rights. The extent of these rights depends on the type of stock purchased, common or preferred.

Common stock represents basic ownership of a corporation. The owner of common stock usually receives one vote for each share of stock. This vote is used to elect a board of directors whose duty is to direct the corporation's business by setting broad policies and goals. The board also hires a professional management team to run the business on a daily basis.

Preferred stock represents nonvoting ownership shares of the corporation. These stockholders receive dividends before common stockholders receive theirs. If the corporation goes out of business, and if some property and funds remain after other debts have been paid, preferred stockholders get their investment back before common stockholders. Because the stock is nonvoting, preferred stockholders do not have the right to elect members to the board of directors.

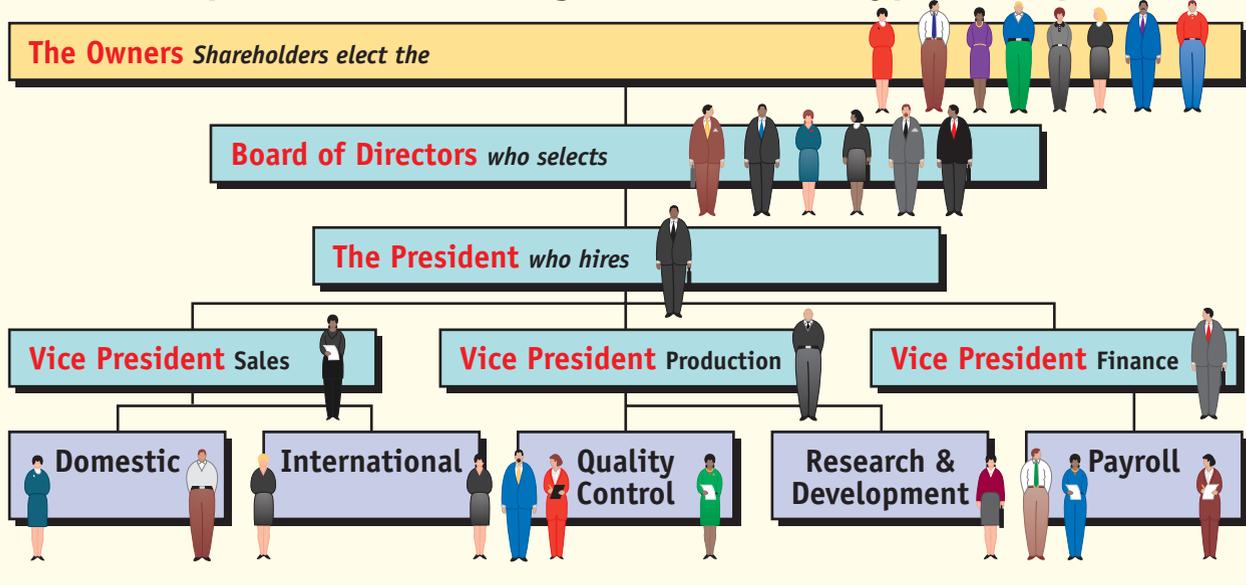
In theory, a stockholder who owns a majority of a corporation's common stock can elect board members and control the company. In some cases,

the common stockholder might even elect himself or herself, and other family members, to the board of directors.

In practice, this is not done very often because most corporations are so large and the number of shares held by the typical stockholder is so small. Most small stockholders either do not vote, or they turn their votes over to someone else. This is done with the use of a proxy, a ballot that gives a stockholder's representative the right to vote on corporate matters.

Finally, **Figure 3.3** presents an organizational chart which shows how the different parts of the organization relate to one another. The chart shows the basic components of the business—sales, production, finance, payroll, etc.—as well as the lines of authority so that everybody knows who they report to.

Ownership, Control, and Organization of a Typical Corporation



Using Charts This organizational chart shows the chain of command of a typical organization. **Who reports directly to the vice president of production?**

Advantages

The main advantage of a corporation is the ease of raising financial capital. If the corporation needs more capital, it can sell additional stock to investors. The revenue can then be used to finance or expand operations. A corporation may also borrow money by issuing bonds. A **bond** is a written promise to repay the amount borrowed at a later date. The amount borrowed is known as the **principal**. While the money is borrowed, the corporation pays **interest**, the price paid for the use of another's money.

A second advantage of a corporation is that the directors of the corporation can hire professional managers to run the firm. This means that the owners, or stockholders, can still own a portion of the corporation without having to know a great deal about the business itself.

A third advantage is that the corporation provides limited liability for its owners. This means that the corporation itself, not its owners, is fully responsible for its debts and obligations. To illustrate, suppose a

corporation cannot pay all of its obligations and goes out of business. Because of limited liability, stockholder losses are limited to the money they invested in stock. Even if other debts remain, the stockholders are not responsible for them.

Because limited liability is so attractive, many firms incorporate just to take advantage of it. Suppose Mr. Winters, who owns the hardware store and the auto repair business, now decides to set up each business as a corporation. If the hardware business should fail, his personal wealth, which includes the automobile repair business, is safe. Mr. Winters may lose all the money invested in the hardware business, but that would be the extent of his loss.

Another advantage is unlimited life, meaning that the corporation continues to exist even when ownership changes. Because the corporation is recognized as a separate legal entity, the name of the company stays the same, and the corporation continues to do business.

The ease of transferring ownership is also a strength of the corporation. If a shareholder no

longer wants to be an owner, he or she simply sells the stock to someone else, who then becomes the new owner. As a result, it is much easier for the owner of a corporation to find a new buyer than it is for a sole proprietor or a partnership.

Disadvantages

One disadvantage of the corporate structure is the difficulty and expense of getting a charter. Depending on the state, attorney's fees and filing expenses can cost several thousand dollars. Because of this expense, many people prefer to set up proprietorships or partnerships.

A second disadvantage of the corporation is that the owners, or shareholders, have little say in how the business is run after they have voted for the board of directors. This is because the directors turn day-to-day operations over to a professional management team, resulting in the separation of ownership and management. This is different from

the proprietorship and partnership, where ownership and management are one and the same.

A third disadvantage is the **double taxation** of corporate profits. Stockholders' dividends are taxed twice—once as corporate profit and again as personal income. This tax status is a consequence of the corporation's special status as a separate legal entity. This also means that the corporation is required to keep detailed records of sales and expenses so that it can compute and pay taxes on its profits.

Finally, corporations are subject to more government regulation than other forms of business. Corporations must register with the state in which they are chartered. If a corporation wants to sell its stock to the public, it must register with the federal Securities and Exchange Commission (SEC). It will also have to provide financial information concerning sales and profits on a regular basis to the general public. Even an attempt to take over another business may require federal government approval.

Business Organizations



Corporations A corporation is an organization owned by many people but treated by law as though it were a person. As a corporation the company can raise money by selling shares of ownership in the business to hundreds or thousands of people. Owners of common stock elect a board of directors. The board of directors, in turn, hires managers to run the business. *How do the holders of common stock differ from the holders of preferred stock?*

Government and Business Regulation



The concept of competitive markets, free from government intervention, has always been a strong part of the U.S. economy. However, in the mid-nineteenth century, states tried to restrict the powers of corporations. By the 1890s, however, courts and legislatures, influenced by business interests and aware that giant corporations were becoming indispensable, had relaxed control over business. States that continued to restrict corporations found their major businesses moving to other states where the laws were more lenient.

Business Regulation

In the twentieth century, various consumer groups demanded regulation of giant corporations. In response, federal and state governments passed stronger regulations. States helped set insurance companies' rates, administered licensing exams, and generally protected consumer interests. Legislation regulated all kinds of corporations, but laws regulating banks, insurance companies, and

companies providing such necessities as electricity, gas, telephone service, or transportation service, were especially rigorous. Recently, states have reduced regulations in order to encourage competition. In the next section, you will read about the ways businesses can grow and expand.

Business Development

State governments are very active in trying to attract new industry. Governors often travel throughout the country or even to foreign countries to draw new business to their states. Television advertising, billboards, brochures, and newspaper advertisements promote travel or business opportunities.

Beginning in the 1930s, state governments sold industrial development bonds to people or institutions and used the money to help finance industries that relocated or expanded within the state. The state paid off the bond within a specified time period from money that the industry paid back to the state in the form of taxes. Today a state may offer an incentive such as a tax credit, or a reduction in taxes, in return for the creation of new jobs or new business investment.

Section 1 Assessment

Checking for Understanding

- 1. Main Idea** Using your notes from the graphic organizer activity on page 57, explain why partnerships are able to attract more capital than sole proprietorships.
- 2. Key Terms** Define sole proprietorship, proprietorship, unlimited liability, inventory, limited life, partnership, limited partnership, bankruptcy, corporation, charter, stock, stockholder, shareholder, dividend, bond, principal, interest, double taxation.
- 3. Identify** the characteristics and organization of the sole proprietorship.
- 4. Discuss** the advantages and disadvantages of the partnership.
- 5. Discuss** the structure and features of the corporation.

Applying Economic Concepts

- 6. Unlimited Liability** Interview one or two business owners in your community and ask them about the formal structure of their business. Ask them how they feel about the issue of unlimited liability. Inquire whether the issue had any influence on the legal form of business they selected.

Critical Thinking

- 7. Drawing Conclusions** When a corporation wants to introduce a potentially profitable but risky product, it frequently sets up a separate company that has its own corporate structure. Why do you think the corporation does this?



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

Profiles IN Economics

A Pioneer in Corporate America: Kenneth I. Chenault

(1951–)

What does it take to succeed at one of America's largest and most prestigious corporations? Kenneth Chenault knows the answer. At the young age of 45, Chenault became president and chief operating officer (COO) of American Express, one of the hundred largest companies in the country.

Chenault is the first African American to serve as president of a top-100 company. Some people have compared him to Jackie Robinson, who broke the color barrier in baseball in 1947. Coincidentally—and perhaps fittingly—Chenault became COO in 1997, the 50th anniversary year of Robinson's breakthrough.

STEPPING STONES

Remarkably, Kenneth Chenault did not start his career in business. Instead, he obtained an undergraduate degree in history, and then earned a law degree at Harvard. He had keen instincts for business, however, and worked for

a management consulting firm before joining American Express in 1981.

CHALLENGES AND OPPORTUNITIES

At first Chenault was responsible for strategic planning. His intelligence and hard work led him up the corporate ranks. Promotions brought Chenault new challenges—and opportunities.

His greatest opportunity now is as chairman and chief executive officer (CEO). Chenault is responsible for integrating strategies across all of American Express's many business units. He has been in the forefront of company efforts to increase market share by expanding product offerings, globalizing the business, and opening American Express's card network to bank partners around the world. Chenault is also responsible for global advertising and brand management.

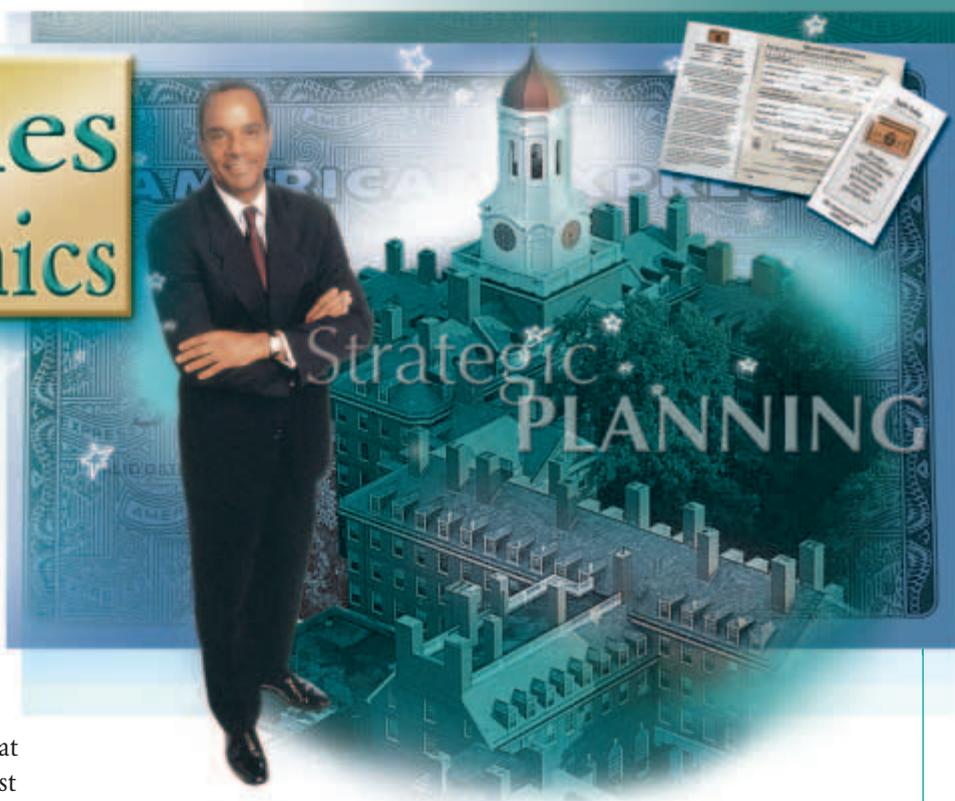
How does Chenault view his tremendous responsibilities as the highest-ranking African American in corporate America?

“With American Express being a large, publicly held company, I would be scrutinized under any circumstances,” Chenault said “If you don't enhance shareholder value, it doesn't matter who you are, you will have a problem. . . . [I]f I do well, I would be very hopeful that it would encourage other companies to give people the opportunity to succeed.”

Kenneth Chenault himself had the opportunity to succeed. And he has proven he knew how to take advantage of it.

Examining the Profile

- 1. Drawing Conclusions** What personal ethics and qualities do you think help make Chenault a success?
- 2. For Further Research** Learn about and report on Chenault's philanthropic contributions in New York City.



Business Growth and Expansion

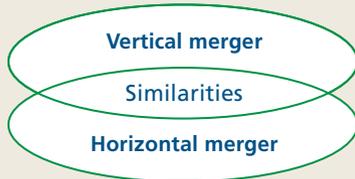
Study Guide

Main Idea

Businesses grow through merging with other companies and by investing in the machinery, tools, and equipment used to produce goods and services.

Reading Strategy

Graphic Organizer As you read the section, complete a graphic organizer similar to the one below by comparing a vertical merger to a horizontal merger.



Key Terms

merger, income statement, net income, depreciation, cash flow, horizontal merger, vertical merger, conglomerate, multinational

Objectives

After studying this section, you will be able to:

1. **Explain** how businesses can reinvest their profits to grow and expand.
2. **Recognize** the reasons that cause firms to merge.
3. **Identify** two different types of mergers.

Applying Economic Concepts

Business Growth Businesses can grow by reinvesting their profits in themselves, or they can combine with another business. Read to find out what influences growth.

Cover Story

Kroger Bags Fred Meyer

Grocery store giant Kroger Co. agreed Monday to purchase rival Fred Meyer Co. in a \$12.8 billion deal that will enable Kroger to reclaim its status as the nation's largest supermarket company. . . . [Analysts say] the merger is a good deal for both companies, one that should create the economies of scale necessary to remain competitive in the tough supermarket industry.

The merger also will enable Kroger to [stay] ahead of rival Albertson's, which otherwise would have eclipsed Kroger through its \$11.7 billion buyout of American Stores Co. in August. . . . Combined with Meyer, currently the fifth-largest grocery chain, Kroger will operate 2,200 supermarkets in 31 states, boasting \$43 billion in annual sales.



Supermarket companies are growing through mergers.

—CNNfn, October 19, 1998

A business can grow in one of two ways. First, it can grow by reinvesting some of its profits. A business can also expand by engaging, much like Kroger did, in a **merger**—a combination of two or more businesses to form a single firm.

Growth Through Reinvestment

Most businesses use some of the revenue they receive from sales to invest in factories, machinery, and new technologies. We can use the **income statement**—a report showing a business's sales, expenses, and profits for a certain period—to illustrate the process. An income statement can reflect various periods of financial activity, such as three months or a year.

Estimating Cash Flows

As illustrated in **Figure 3.4**, the business first records its total sales for the period. Next, it finds its **net income** by subtracting all of its expenses, including taxes, from its revenues. These expenses include the cost of any goods such as inventory,

wages and salaries, interest payments, and **depreciation**, a non-cash charge the firm takes for the general wear and tear on its capital goods.

Depreciation is called a *non-cash charge* because, unlike other expenses shown in the figure, the money is never paid to anyone else. For example, interest may be paid to a bank, wages may be paid to employees, but the money allocated to depreciation never goes anywhere—it simply stays in the business.

The concept of **cash flow**, the sum of net income and non-cash charges such as depreciation, is the *bottom line*, or real measure of profits for the business. This is because the cash flow represents the total amount of new funds the business generates from operations.

Reinvesting Cash Flows

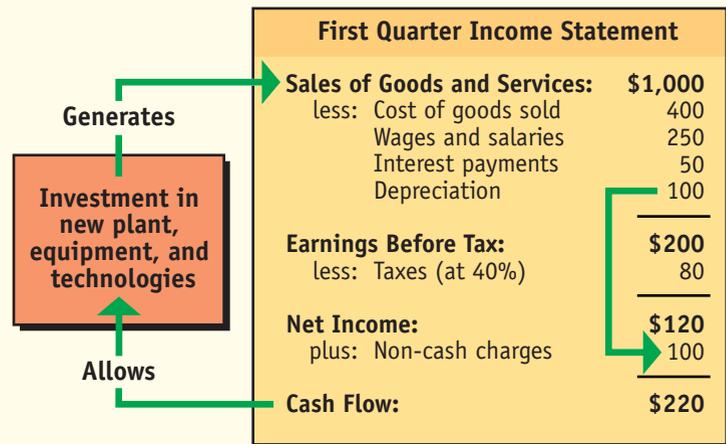
The business owners, either directly in the case of the proprietorship or partnership, or indirectly through the board of directors in the case of the corporation, decide how the cash flow will be allocated. Some of it can be paid back to owners as their reward for risk taking, or the funds can be reinvested in the form of new plant, equipment, and technologies.

When cash flows are reinvested in the business, the firm can produce additional products. This generates additional sales and a larger cash flow during the next sales period. As long as the firm remains profitable, and as long as the reinvested cash flow is larger than the wear and tear on the equipment, the firm will grow.

Growth Through Mergers

 When firms merge, one gives up its separate legal identity. For public recognition purposes, however, the name of the new company may reflect the identities of the merged companies. When Chase National Bank and Bank of Manhattan

Business Growth Through Reinvestment



Using Charts One way for a business to grow is to invest some of its cash flow in new plant, equipment, and technologies so that it can generate even more sales in the future. **Which of the items on the income statement represents the real measure of profits for the business?**

merged, the new organization was called the Chase Manhattan Bank of New York—a name later changed to Chase Manhattan Corporation to reflect its geographically expanding business.

Mergers take place for a variety of reasons. A firm may seek a merger to grow faster, to become more efficient, to acquire or deliver a better product, to eliminate a rival, or to change its image.

Reasons for Merging

Some managers find that they cannot grow as fast as they would like using the funds they generate internally. As a result, the firm may look for another firm with which to merge. Sometimes a merger makes sense, and other times it may not, but the desire to be bigger—if not the biggest—is one reason that mergers take place.



WHEN YOU SAY PROFITS, SMILE

Understanding the values of your customers is an important part of doing business. In this excerpt, an analyst promotes the importance of smiling to a group of Japanese businesspeople.

Some 30 somber businessmen in plain blue suits are biting down on chopsticks and feeling silly. "Now pull them out slowly," instructs their teacher, Yoshihiko Kadokawa, and suddenly the Japanese men seem to be grinning. . . . "There you go, you are now smiling," beams Kadokawa, 47. "Doesn't it feel great?"

Second nature to politicians and game show hosts, the toothy grin has long been a cultural no-no in Japan, where some people still cover their mouths when they laugh in public and children are taught to limit their expressiveness, lest they upset the *wa*, or sense of group harmony. But Kadokawa, a former department store executive who noticed that his friendliest clerks racked up the biggest sales, wants to turn Japan into the land of happy

lips. He charges up to \$1,000 to host his two-to-three-hour "Let's Smile Operation" seminars, in which students exercise recalcitrant facial muscles and try to grasp the notion that smiles equal sales. "If you do not smile, you cannot make a profit," says Kadokawa, mindful that his country is mired in its worst economic crisis in decades. "If Japan smiled more, perhaps this nasty recession would end."

Look what it has done for Kadokawa, who has also written a popular book, *The Power of a Laughing Face*. His clients, however, mostly men, are having a harder time of it. "Won't I look stupid if I smile?" asks one. "Is it good for your health?" inquires another. Kadokawa assures them that showing their pearly whites is the key to prosperity. Perhaps his most helpful tip: Study Bill Clinton. "Look at the way he smiles," says Kadokawa. "That is real power."

—*People Weekly*, May 10, 1999

Critical Thinking

1. **Analyzing Information** What is Kadokawa trying to teach the group?
2. **Synthesizing Information** How important is it for business people who work with people from other countries to understand their values?

Efficiency is another reason for mergers. When two firms merge, they no longer need two presidents, two treasurers, and two personnel directors. The firm can have more retail outlets or manufacturing capabilities without significantly increasing management costs. In addition, the new firm may be able to get better discounts by making volume purchases, and make more effective use of its advertising. Sometimes the merging firms can achieve two objectives at once—such as dominant size and improved efficiency—as in the case of the Kroger-Meyer merger.

Some mergers are driven by the need to acquire new product lines. Recent telecommunications industry mergers, for example, were driven by the desire for some firms to provide better communications services. As a result, former telephone companies like AT&T bought cable TV firms so

that they could offer faster internet access and telephone service in a single package.

Sometimes firms merge to catch up with, or even eliminate, their rivals. Royal Caribbean Cruises acquired Celebrity Cruise Lines in 1997 and nearly doubled in size, becoming the second largest cruise line behind Carnival. When the office supply store Staples tried to acquire Office Depot in the same year, however, the government blocked the merger on the grounds that it would reduce competition in the industry.

Finally, a company may use a merger to *lose* its corporate identity. In 1997 ValuJet merged with AirWays to form AirTran Holdings Corporation. The new company flew the same planes and routes as the original company, but AirTran hoped the name change would help the public forget ValuJet's tragic 1996 Everglades crash that claimed 110 lives.

Types of Mergers

Economists generally recognize two types of mergers. The first is a **horizontal merger**, which takes place when two or more firms that produce the same kind of product join forces. The merger of the two banks, Chase National and the Bank of Manhattan, is one such example.

When firms involved in different steps of manufacturing or marketing join together, we have a **vertical merger**. An automaker merging with a tire company is one example of a vertical merger. Another is the U.S. Steel Corporation. At one time, it mined its own ore, shipped it across the Great Lakes, smelted it, and made steel into many different products. Vertical mergers take place when companies believe that it is important to protect themselves against the loss of suppliers.

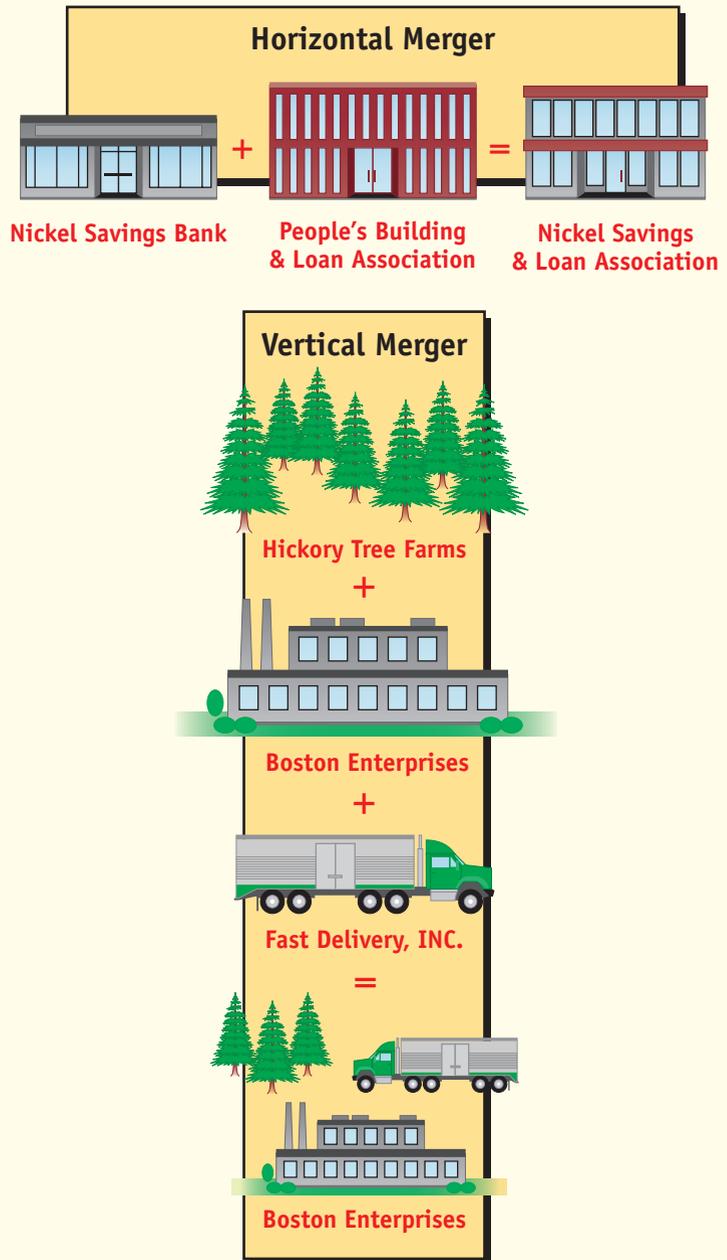
Conglomerates

A corporation may become so large through mergers and acquisitions that it becomes a conglomerate. A **conglomerate** is a firm that has at least four businesses, each making unrelated products, none of which is responsible for a majority of its sales.

Diversification is one of the main reasons for conglomerate mergers. Some firms believe that if they do not “put all their eggs in one basket,” their overall sales and profits will be protected. Isolated economic happenings, such as bad weather or the sudden change of consumer tastes, may affect some product lines at some point, but not all at one time.

During the 1970s and early 1980s, conglomerate mergers were popular in the United States. The cigarette and tobacco firm of R.J.

Business Combinations



Using Charts Horizontal and vertical mergers are two kinds of mergers. **What is the difference between these two kinds of mergers?**

Figure 3.6

Conglomerate Structure

Office Products

ACCO office supplies
Swingline staplers
Day-Timers personal organizers

Golf Products

Titleist golf balls
Foot-Joy golf shoes
Cobra golf clubs

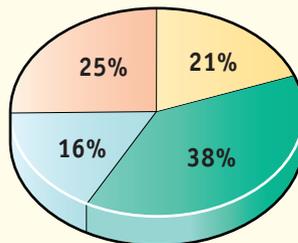
Home Products

Moen faucets
Master Lock
Waterloo toolboxes

Spirits and Wines

Sales by Category

Home Products	38%
Office Products	25%
Spirits and Wines	21%
Golf Products	16%



Source: <http://www.fortunebrands.com>, 2001

Using Charts A conglomerate is a firm that has at least four businesses, each of which makes unrelated products and none of which is responsible for a majority of its sales. Fortune Brands is an American conglomerate with a wide range of products. About 25 percent of Fortune Brand's sales come from international sales. **How does a conglomerate differ from a multinational?**

Reynolds became a leading conglomerate, at one time owning the largest containerized shipping firm in the country (Sea-Land), the nation's second largest fast-food chain (Kentucky Fried Chicken), the nation's largest fruit and vegetable processor (Del Monte), and the second largest producer of wine and distilled spirits (Heublein).

Since the late 1980s, the number of conglomerates in the United States has declined. In Asia, however, conglomerates remain strong. Samsung, Gold Star, and Daewoo are still very dominant in Korea, as are Mitsubishi, Panasonic, and Sony in Japan.

Multinationals

Other large corporations have become international in scope. A **multinational** is a corporation that has manufacturing or service operations in a number of different countries. It is, in effect, a citizen of several countries at one time. As such, a multinational is subject to the laws of, and is likely to pay taxes in, each country where it has operations. General Motors, Nabisco, British Petroleum, Royal Dutch Shell, Mitsubishi, and Sony are examples of global corporations that have attained worldwide economic importance.

Multinationals are important because they have the ability to move resources, goods, services, and financial capital across national borders. A multinational with its headquarters in Canada, for example, is likely to sell bonds in France. The proceeds may then be used to expand a plant in Mexico that makes products for sale in the United States. Multinationals may

also be conglomerates if they make a number of unrelated products, but when they conduct their operations in several different countries they are more likely to be called a multinational.

Multinationals are usually welcome because they transfer new technology and generate new jobs in areas where jobs are needed. Multinationals also produce tax revenues for the host country, which helps that nation's economy.

At times, multinationals have been known to abuse their power by paying low wages to workers, exporting scarce natural resources, or by adversely interfering with the development of local businesses. Some analysts point out that multinational corporations will be increasingly able to demand tax, regulatory, and wage concessions by threatening to move their operations to another country. Only highly educated people or those with skills will benefit as wages remain low. Other analysts predict uneven development. One region of the world will grow at the expense of another.

Most economists, however, welcome the low-cost production and quality that competition in the global economy brings. They also believe a greater use of research and new technology will raise the standard of living for all people. On balance, the advantages of multinationals far outweigh the disadvantages.

Careers

Buyer

Buyers purchase merchandise for resale to the public. They choose the suppliers, negotiate the price, and award contracts.

The Work

Duties include anticipating consumer demand, staying informed about new products, attending trade shows, and checking shipments. Buyers assist in sales promotions and advertising campaigns, as well as checking on displays. Buyers must have the ability to plan, make decisions quickly, work under pressure, and identify products that will sell. Most buyers work in wholesale and retail trade companies, such as grocery or department stores, or in manufacturing. Many others work in government or in service industries.

Qualifications

Most buyers have completed a college degree with a business emphasis. Familiarity with the merchandise as well as with wholesaling and retailing practices is important.



Section 2 Assessment

Checking for Understanding

- 1. Main Idea** Using your notes from the graphic organizer activity on page 68, explain how mergers improve efficiency.
- 2. Key Terms** Define merger, income statement, net income, depreciation, cash flow, horizontal merger, vertical merger, conglomerate, multinational.
- 3. Describe** how a firm can generate funds internally to grow and expand.
- 4. Identify** five reasons why firms merge.
- 5. Describe** the different ways a business can merge.

Applying Economic Concepts

- 6. Business Growth** In a newspaper or magazine, find an article about a merger. What companies merged? What reasons, if any, were given for the merger? What statistics were provided? Write a one-page paper in which you answer these questions.

Critical Thinking

- 7. Making Comparisons** What are the possible ethical benefits and drawbacks of multinationals to their host countries?



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

BusinessWeek

JUNE 28, 1999

Newsclip

Cosmetic companies like L'Oréal have found a profitable strategy: acquire smaller cosmetic companies and promote the culture from which they came. With this formula, and with the help of chief executive Lindsay Owen-Jones, L'Oréal's profits have dramatically increased.

The Beauty of Global Branding

It's a sunny afternoon outside Parkson's department store in Shanghai, and a marketing battle is raging for the attention of Chinese women. Tall, pouty models in beige skirts and sheer tops pass out flyers promoting Revlon's new spring colors. But their efforts [are being] drowned out by L'Oréal's eye-catching show for its Maybelline brand.

To a pulsating rhythm, two gangly models in shimmering lycra tops dance on a podium before a large backdrop depicting the New York City skyline. The music stops, and a makeup artist transforms a model's face while a Chinese saleswoman delivers the punch line. "This brand comes from America. It's very trendy," she shouts into the microphone. "If you want to be fashionable, just choose Maybelline."

Few of the women in the admiring crowd realize that the trendy "New York" Maybelline brand belongs to French cosmetics giant L'Oréal. In the battle for global beauty markets, \$12.4 billion L'Oréal has developed a winning formula: a growing portfolio of international brands that have transformed the French company into the U.N. of beauty. . . .

Its secret: conveying the allure of different cultures through its many products. Whether it's selling Italian elegance, New York street smarts, or French beauty through its brands, L'Oréal is reaching out to a vast range of people across incomes and cultures. . . .

L'Oréal's work with Maybelline is a prime example. In 1996, L'Oréal acquired Maybelline for \$758 million and began a makeover of the brand. The key: figuratively stamping "urban American chic" all over Maybelline products to promote their American origins. . . .

"That's a big challenge for this company to add brands, yet keep the differentiation," says Marlene Eskin, publisher of *Market View* research reports on the cosmetics industry.

—Reprinted from June 28, 1999 issue of *Business Week*, by special permission, copyright © 1999 by The McGraw-Hill Companies, Inc.



Department store in Shanghai, China

Examining the Newsclip

- 1. Analyzing Information** How has L'Oréal become more competitive in the global market?
- 2. Summarizing Information** In your own words, explain why it is a challenge for a company to "add brands, yet keep differentiation"?

Other Organizations

Study Guide

Main Idea

Producer and worker cooperatives are associations in which the members join in production and marketing to lower costs for their members' benefit.

Reading Strategy

Graphic Organizer As you read the section, complete a graphic organizer similar to the one below by describing the different kinds of cooperatives.



Key Terms

nonprofit organization, cooperative, co-op, credit union, labor union, collective bargaining, professional association, chamber of commerce, Better Business Bureau, public utility

Objectives

After studying this section, you will be able to:

1. **Describe** nonprofit organizations.
2. **Explain** the direct and indirect role of government in our economy.

Applying Economic Concepts

Nonprofit Organizations Do you belong to a church, club, or civic organization? Read to find out how these organizations fit into our economic system.

Cover Story

Baby-Sitting Co-Ops a Growing Trend

When Candace and Roger Kuebel of Larchmont, N.Y., flew to Grenada for a week's vacation, they did something most parents of young children do only in their dreams. The Kuebels left their two-year-old daughter, Heather, in the care of two responsible adults—parents themselves . . . they also didn't pay a child care service any costly fees.

The couple's secret: They belong to a baby-sitting cooperative.

The idea behind the baby-sitting co-op is simple: Families swap baby-sitting duties without ever exchanging money. Co-ops usually rely on a coupon system: members with coupons have an incentive to use them, while those low on coupons need to sit.

—*The New York Times On the Web*, February 1, 1998



Baby-sitting duties

Most businesses use scarce resources to produce goods and services in hopes of earning a profit for their owners. Other organizations, like the baby-sitting co-op described in the cover story, operate on a “not-for-profit” basis. A **nonprofit organization** operates in a businesslike way to promote the collective interests of its members rather than to seek financial gain for its owners.

Community and Civic Organizations

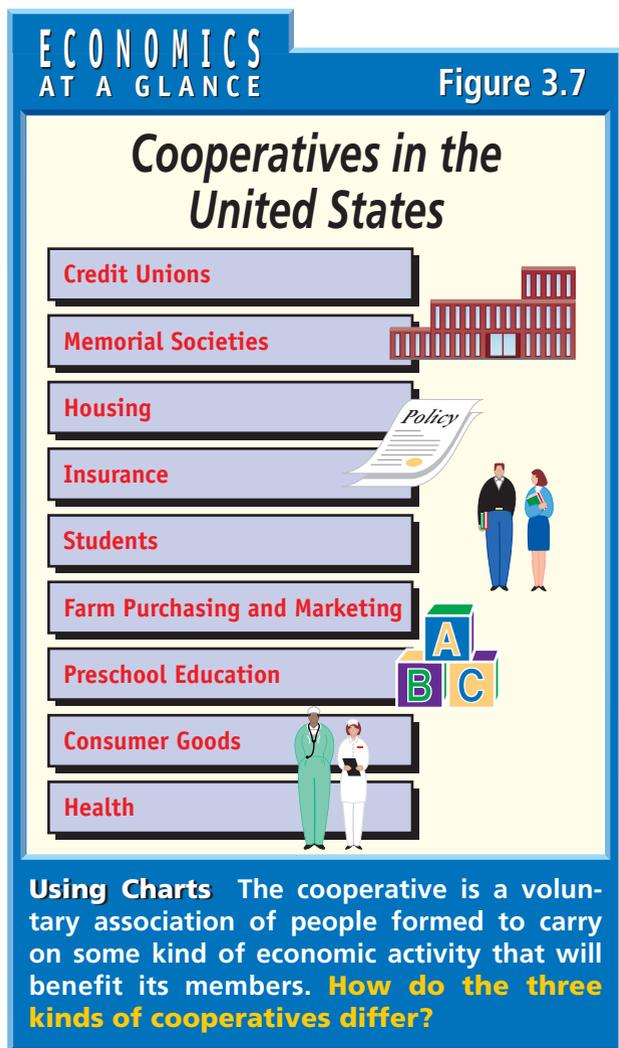
Examples of nonprofit institutions include organizations such as schools, churches, hospitals, welfare groups, and adoption agencies. Most of these organizations are legally incorporated to take advantage of unlimited life and limited liability. They are similar to profit-seeking businesses, but do not issue stock, pay dividends, or pay income taxes.

These organizations often provide goods and services to their members while they pursue other rewards such as improving educational standards, seeing the sick become well, and helping those in need. Their activities often produce revenues in excess of expenses, but they use the surplus to further the work of their institutions.

Nonprofit community and civic organizations use scarce factors of production to serve many needs. Their efforts are difficult to analyze economically, however, because the value of their products is not easy to measure. Even so, the large number of these organizations shows that they are an important part of our economic system.

Cooperatives

 Another example of a nonprofit organization is the **cooperative**, or **co-op**. A cooperative is a voluntary association of people formed to carry on some kind of economic activity that will benefit its members. Cooperatives fall into three major classes: consumer, service, and producer.



Consumer Cooperatives

The consumer cooperative is a voluntary association that buys bulk amounts of goods such as food and clothing on behalf of its members. Members usually help keep the cost of the operation down by devoting several hours a week or month to the operation. If successful, the co-op is able to offer its members products at prices lower than those charged by regular businesses.

Service Cooperatives

A service cooperative provides services such as insurance, credit, and baby-sitting to its members, rather than goods. One example is a **credit union**, a financial organization that accepts deposits from, and makes loans to, employees of a particular company or government agency. In most cases, credit union members can borrow at better rates and more quickly than they could from for-profit banks or commercial loan companies.

Producer Cooperatives

Producers, like consumers, can also have co-ops. A producer cooperative helps members promote or sell their products. In the United States, most cooperatives of this kind are made up of farmers. The co-op helps the farmers sell their crops directly to central markets or to companies that use the members' products. Some co-ops, such as the Ocean Spray cranberry co-op, market their products directly to consumers.

Labor, Professional, and Business Organizations

 Non-profit organizations are not just limited to co-ops and civic groups. Many other groups also organize this way to promote the interests of their members.

Labor Unions

Another important economic institution is the **labor union**, an organization of workers formed to represent its members' interests in various

Cooperatives

Benefits A cooperative is an organization that is owned by and operated for the benefit of those using its services. Consumer cooperatives, service cooperatives, and producer cooperatives perform different functions. *What are the benefits of a consumer cooperative?*



employment matters. The union participates in **collective bargaining** when it negotiates with management over issues such as pay, working hours, health care coverage, life insurance, vacations, and other job-related matters.

Unions pressure the government to pass laws that will benefit and protect their workers. The largest labor organization in the United States is the American Federation of Labor-Congress of Industrial Organizations (AFL-CIO), an association of unions whose members do all kinds of work. The American Postal Workers Union and the American Federation of Teachers, for example, are both AFL-CIO unions. Many other unions, such as the National Education Association for Teachers, are independent and represent workers in specific industries.

Professional Associations

Many workers belong to professional societies, trade associations, or academies. While these groups are similar to unions, they do not work in quite the same way. One such organization is a **professional association**—a group of people in a specialized occupation that works to improve the

working conditions, skill levels, and public perceptions of the profession.

The American Medical Association (AMA) and the American Bar Association (ABA) are two examples of interest groups that include members of specific professions. Basically, these two groups influence the licensing and training of doctors and lawyers, and both groups are actively involved in political issues. Professional associations also represent bankers, teachers, college professors, police officers, and hundreds of other professions. While these associations are concerned primarily with the standards of their professions, they also seek to influence government policy on issues that are important to them.

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ECONOMICS
Online



Student Web Activity Visit the *Economics: Principles and Practices* Web site at tx.epp.glencoe.com and click on **Chapter 3—Student Web Activities** for an activity on the Better Business Bureau.

Did you know?

What's in a Name? People often define themselves by the work they do. Many common English surnames are based on occupations. Examples are Smith, Cooper, Carpenter, Weaver, Baker, and Potter.

Business Associations

Businesses also organize to promote their collective interests. Most cities and towns have a **chamber of commerce** that promotes the welfare of its members and of the community. The typical chamber sponsors activities ranging from educational programs to neighborhood clean-up campaigns to lobbying for favorable business legislation.

Many business organizations represent specific kinds of businesses. These are called industry or trade associations. Trade associations are interested in shaping the government's policy on such economic issues as free enterprise, imports and tariffs, the minimum wage, new construction, and government contracts for construction and manufacturing. The Telecommunications Industry Association, for instance, represents manufacturers and suppliers of communications and information technology products on issues affecting its members.

Some business associations help protect the consumer. The **Better Business Bureau**, a nonprofit organization sponsored by local businesses

CYBERNOMICS SPOTLIGHT

The Changing Workplace

In studying the workplace, some analysts feel that certain trends will continue. People will change jobs several times during their lifetimes. The compressed work schedule—working a shorter workweek with more hours per day—will continue to make inroads. Analysts also believe that lifelong learning is a key to career success. New jobs require advanced skills, education, and training. Therefore, the need for continuing to learn and develop new skills is more important than ever before.

—Source: *Computer Industry Almanac*

to provide general information on companies, is one of these. It maintains records on consumer inquiries and complaints and sometimes offers various consumer education programs.

Government



Government is another nonprofit economic organization. Sometimes government plays a direct role in the economy, while at other times the role is indirect.

Direct Role of Government

Many government agencies produce and distribute goods and services to consumers, giving government a direct role in the economy. The role is “direct” because the government supplies a good or service that competes with private businesses.

One example is the Tennessee Valley Authority (TVA). The TVA supplies electric power for almost all of Tennessee and parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina, and Virginia. This power competes directly with the power supplied by other, privately owned, power companies.

Another example is the Federal Deposit Insurance Corporation (FDIC), which insures deposits in our nation's banks. Because the insurance the FDIC supplies could be provided by privately owned insurance companies, the FDIC is also an example of the direct role of government.

Perhaps the best known of the government corporations is the U.S. Postal Service (USPS). Originally an executive department called the Post Office Department, the USPS became a government corporation in 1970.

Many of these federal agencies are organized as government-owned corporations. Like those of privately owned businesses, these corporations have a board of directors that hires a professional management team to oversee daily operations. These corporations charge for the products they produce, and the revenue goes back into the “business.” If the corporation has losses, however, they are covered by funds supplied by Congress.

State and local governments provide police and fire protection, rescue services, schools, and court systems. At the same time, all levels of government

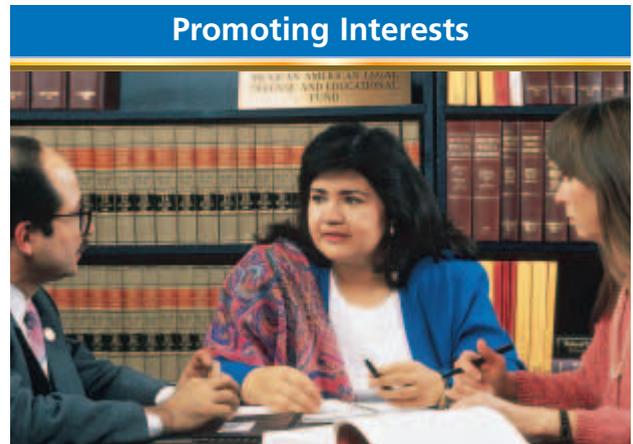
help develop and maintain roads, libraries, and parks. In these ways, government plays a direct part in the productive process.

Indirect Role of Government

The government plays an indirect role when it acts as an umpire to make sure the market economy operates smoothly and efficiently. One such case is the regulation of **public utilities**, investor- or municipal-owned companies that offer important products to the public, such as water or electric service.

Because many public utilities have few competitors, people often want government supervision. For example, government established regulatory control over the cable television industry in 1993 because it felt that some operators were charging too much. Without competition, utilities and other companies having exclusive rights in certain areas may not offer services at reasonable rates.

The government also plays an indirect role when it grants money to people in the form of Social Security, veterans' benefits, financial aid to college students, and unemployment compensation. Such payments give the recipients of these funds a power



Promoting Interests

Methods Labor unions, professional and business organizations, and interest groups draw from the financial resources and expertise of their members. *Who makes up the membership of a professional association?*

they otherwise might not have—the power to “vote” and to make their demands known in the market. This power influences the production of goods and services that, in turn, affects the allocation of scarce resources.

Section 3 Assessment

Checking for Understanding

- 1. Main Idea** Using your notes from the graphic organizer activity on page 75, describe the different types of cooperatives.
- 2. Key Terms** Define nonprofit organization, cooperative, co-op, credit union, labor union, collective bargaining, professional association, chamber of commerce, Better Business Bureau, public utility.
- 3. Identify** the purpose of the different types of nonprofit organizations.
- 4. Provide** examples that illustrate the government's direct and indirect roles as an economic institution.

Applying Economic Concepts

- 5. Nonprofit Organizations** Name a nonprofit organization that you or one of your friends

have joined. Research the history of the organization to find out how it began and its stated goals. State the purpose of the organization, and then compare its activities to profit-making organizations. If your organization collects more than it spends, what does it do with the extra money?

Critical Thinking

- 6. Classifying Information** Make a list of 10 activities performed by your local government. Classify each as to its direct or indirect influences on the local economy.
- 7. Making Comparisons** Why do many people prefer to deal with credit unions rather than banks?



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

STUDY AND WRITING

Skill

Taking Notes

Effective note taking involves more than just writing facts in short phrases. It involves breaking up the information into meaningful parts so that it can be understood and remembered.



Business in the United States can be organized in a number of ways.

Learning the Skill

To take good notes, follow these steps.

- When taking notes on material presented in class, write the key points, along with the important facts and figures, in a notebook.
- Write quickly and neatly, using abbreviations and phrases.
- Copy words, statements, or diagrams drawn on the chalkboard.
- Ask the teacher to repeat important points you have missed or do not understand.
- When studying textbook material, organize your notes into an outline. When outlining written material, first read the material to identify the main ideas. Next, identify the subheads. Place details supporting or explaining subheads under the appropriate head.
- For a research report, take notes on cards. Note-cards should include the title, author, and the page number of sources.

Practicing the Skill

Suppose you are writing a research report on the topic, Business Organizations. First, identify main idea questions about this topic, such as “What are the different kinds of business organizations?” “How are they formed?” and “What are their advantages and disadvantages?” Then find material about each main-idea question.

Using this textbook as a source, read the material on “Forms of Business Organization,” beginning on page 57. Then, review the material and prepare notes like those below.

Topic: *Business Organizations*

Main Idea: *Different kinds*

1. *The sole proprietorship is one kind of bus. org.*

2.

3.

Main Idea: *Formation differs by kind of org.*

1.

2.

3.

Application Activity

Scan a local newspaper for a short editorial or an article about an event pertaining to business or the economy. Take notes by writing the main idea and supporting facts. Summarize the article using only your notes.



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Chapter 3 Summary

Section 1

Forms of Business Organization

(pages 57–66)

- **Sole proprietorships** are small, easy-to-manage enterprises owned by one person. They are relatively numerous and profitable. Disadvantages include raising financial capital and attracting qualified employees.
- **Partnerships** are owned by two or more persons. Their slightly larger size makes it easier to attract financial capital and qualified workers. Disadvantages include the **unlimited liability** of each general partner for the acts of the other partners, the **limited life** of the partnership, and the potential for conflict among partners.
- **Corporations** are owned by **shareholders** who vote to elect the board of directors. Shareholders have **limited liability** and are not liable for the actions or debts of the corporation. The relatively large size of the corporation allows for specialized functions and large-scale manufacturing within the firm.
- Disadvantages of corporations include the cost of obtaining charters, limited shareholder influence over corporate policies, and having to deal with some government regulations.
- The corporation is recognized as a separate legal entity and so must pay a separate corporate income tax not paid by proprietorships and partnerships.



Section 2

Business Growth and Expansion

(pages 68–73)

- Businesses can grow by reinvesting their **cash flows** in plant, equipment, and new technology.

- Businesses can also expand through **mergers**. Most mergers take place because firms want to become bigger, more efficient, acquire a new product, catch up to or eliminate a competitor, or change its corporate identity.
- A **horizontal merger** takes place when two firms that produce similar products come together. A **vertical merger** is one that involves two or more firms at different stages of manufacturing or marketing.
- A **conglomerate** is a large firm that has at least four different businesses, none of which is responsible for a majority of sales.
- A **multinational** can be an ordinary corporation or a conglomerate, but it has manufacturing or service operations in several different countries. Multinationals introduce new technology, generate jobs, and produce tax revenues for the host countries.



Section 3

Other Organizations

(pages 75–79)

- **Nonprofit organizations** function like a business, but on a not-for-profit basis to further a cause or for the welfare of their members.
- The **cooperative**, or **co-op**, is one of the major nonprofit organizations. The co-op can be organized to provide goods and services, or to help producers.
- **Professional associations** work to improve the working conditions, skill levels, and public perceptions of their profession.
- Businesses often form a **chamber of commerce** or a **Better Business Bureau** to promote their collective interests.
- Government plays a direct role in the economy when it provides goods and services directly to consumers; it plays an indirect role when it provides Social Security, veterans' benefits, unemployment compensation, and financial aid to college students, or when it regulates businesses.

ECONOMICS Online



Self-Check Quiz Visit the *Economics: Principles and Practices* Web site at tx.epp.glencoe.com and click on **Chapter 3—Self-Check Quizzes** to prepare for the chapter test.

CLICK HERE

Identifying Key Terms

On a separate sheet of paper, classify each of the numbered terms below into the following categories (some terms may apply to more than one category):

- Sole Proprietorships
- Corporations
- Partnerships
- Nonprofit Organizations

1. bond
2. stock
3. cooperative
4. dividend
5. unlimited liability
6. charter
7. labor union
8. professional association
9. limited partner
10. credit union

Reviewing the Facts

Section 1 (pages 57–66)

1. **Explain** the strengths of a sole proprietorship.
2. **Identify** the weaknesses of a partnership.
3. **Explain** the structure and strengths of a corporation.

Section 2 (pages 68–73)

4. **Explain** how the firm obtains, and then disposes of, its cash flow.
5. **Describe** the difference between a horizontal and a vertical merger.

6. **Explain** why a corporation might choose to become a conglomerate.

Section 3 (pages 75–79)

7. **Describe** the difference between a nonprofit institution and other forms of business organizations.
8. **List** three examples of cooperative associations.
9. **Describe** the purpose of a labor union.
10. **Identify** three types of business or professional organizations.
11. **Compare** the direct and the indirect roles of government.

Thinking Critically

1. **Making Comparisons** If you were planning to open your own business, such as a sportswear store or a lawn service, which form of business organization would you prefer—sole proprietorship, partnership, or corporation? Give reasons for your answer. To help you organize your response, begin by setting up a diagram like the one below.



2. **Drawing Conclusions** Do you think mergers are beneficial for the U.S. economy? Defend your response.
3. **Synthesizing Information** List the strengths and weaknesses of each type of business organization. Then share the list with the owner of a business in your community. Ask the owner which items on the list were the most influential in deciding how to organize his or her business. Write a report summarizing your findings.

Applying Economic Concepts

- 1. Economic Institutions** Cite a case in your community where a cooperative would fulfill a definite economic need. Explain why you think so, and then tell what kind of cooperative you would set up.
- 2. The Role of Government** Which do you think is more appropriate—the direct or indirect role of government? Defend your position.
- 3. Unlimited Liability** What is the difference between the unlimited liability of proprietorships and partnerships, and the limited liability of corporations?
- 4. Business Growth** What advantages might a multinational bring to a host nation?
- 5. Nonprofit Organizations** In what ways does a consumer cooperative differ from a service cooperative?

Math Practice

Study the table that follows. Then answer the questions.

Sole Proprietorships, 1987–1997			
	1987	1992	1997
Business Receipts	610,823	737,082	870,392
Business Deductions	505,362	725,666	858,453
Net Income			

In millions of dollars

Source: *Statistical Abstract of the United States, 2000*

1. What is the net income for each of the three years listed? How did you find the answer?
2. In what year did sole proprietorships have the largest net income?

3. In what year did sole proprietorships have the largest net income as a percentage of business receipts? How did you find your answer?

Thinking Like an Economist

Identify two ways a firm's cash flow can be used. Explain why these uses are a trade-off and explain the opportunity costs of these choices in terms of the firm's future growth.

Technology Skill

Using the Internet With the increase in multinational corporations, many American citizens are interacting more and more with different cultures in other countries. Imagine that you and a partner have set up a multinational corporation that operates in the global economy. Select a country and use the Internet to research its culture in relation to business protocol. Use the information to create a report that lists procedures and key words your employees will need to know in order to properly conduct business in the country. Share your findings with the members of your class.

Building Skills

Taking Notes Research to find out more about an American entrepreneur and his or her role in shaping the U.S. economy. Before you do any research, compile a list of questions to serve as a guide and to narrow your topic. Consider such questions as:

1. Whom shall I research?
2. What did he or she invent or promote?
3. How did he or she become a successful entrepreneur?
4. What effect did this entrepreneur have on the U.S. economy?

Use your notes to help you write a two-page typewritten sketch of the entrepreneur.



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

A Case Study:

ARE MEGAMERGERS HARMFUL?

Financial analysts called the 1990s “the decade of the megamerger,” and it’s easy to see why. The decade saw an unprecedented number of “megamergers”—multi-*billion* dollar deals that combine already huge firms into even larger business giants.

In the oil industry, two giants—Exxon and Mobil—agreed to merge. The value of the deal? An estimated \$80 billion—Wall Street’s biggest deal ever. In the telecommunications industry, AT&T acquired cable giant Tele-Communications, Inc. for some \$48 billion. Daimler-Benz AG, an auto industry giant, acquired Chrysler Corporation in an estimated \$38 billion deal. In the financial industry, German bank Deutsche Bank took over Bankers Trust Corporation (a \$10 billion-plus deal), creating the world’s largest bank.

These megamergers are only a few highlights of the trend toward megamergers in many industries—a trend that shows no signs of stopping. But what are the consequences of megamergers?

As you read the selections, ask yourself:
Are megamergers beneficial or harmful?



Megamergers Are a Threat

The fierce competitive pressures forcing megamergers, such as cost-cutting and the need to achieve scale in the global economy, are understandable. But the mergers raise a broad issue that goes beyond traditional concerns. . . .

The big problem with these gigantic mergers is the growing imbalance between public and private power in our society. . . . [N]owadays an era of Big Government is being superseded by the age of global giants.

Superlarge companies with interests and commitments stretching from Boston to Brisbane are unlikely to focus as intensely as smaller ones do on support for the local neighborhoods—the schools, the arts, the development of research activities, the training of potential workers. . . .

Big companies have disproportionate clout on national legislation. Our scandalously porous laws for campaign contributions leave little doubt that megacompanies will exercise huge power over politicians when it comes to such issues as environmental standards, tax policy, Social Security, and health care. . . .

Megacompanies are almost beyond the law, too, because their deep pockets allow them to stymie prosecutors in ways smaller defendants cannot. Or, if they lose in court, they can pay large fines without much damage to their operations.

Corporate giants will also exert massive pressure on America’s international behavior. Defense contractors such as Lockheed Martin, the result of a 1995 merger, have successfully pushed for NATO expansion and for related military sales to Poland, the Czech Republic, and others. Combined entities such as Boeing-McDonnell Douglas will tighten their already formidable grip on U.S. trade policy. Companies like Exxon-Mobil Corp. will deal with oil-producing countries

almost as equals, conducting the most powerful private diplomacy since the British East India Company wielded near-sovereign clout throughout Asia. . . .

The American economic system is at its best when public and private needs are balanced. The sheer magnitude of mergers is skewing the equilibrium.

—Jeffrey E. Garten, Dean of the Yale School of Management



Megamergers Are Harmless

We are witnessing an interesting collision between history and headlines. The headlines herald a new era of menacing corporate power. . . .

Big business seems to be getting ever bigger and more powerful.

Well, not exactly. The correct lesson from history is just the opposite: corporate power is on the wane.

If this seems counterintuitive, it's also common sense. Big business has been brought to heel politically. Everything from child labor to the environment has been regulated. Government is the final arbiter of business behavior, even if government is often arbitrary. This is an old story. Less recognized—or perhaps forgotten—is the fact that companies have also lost much market power to set prices and determine what customers buy. . . .

We can all identify the major forces that have corroded corporate market power: new technology (personal computers and cable TV); foreign competition (automobiles); the end of legal monopoly (telephones). But there is a less visible force that subverts overall corporate power, and that is economic growth itself. As society becomes richer, people buy a greater array of goods and

services. When the typical market basket grows, producers of traditional goods become less important. . . .

Megamergers do not contradict this picture. One reason is that today's merger is often tomorrow's bust-up. Some mergers fail because they're driven more by personal ambition than true efficiency. . . .

Some mergers may also be blatantly collusive. Corporate executives regularly complain about lost “pricing power” (this may be a reason inflation has stayed tame). What better way to restore it than by buying a competitor? This is a genuine antitrust worry, but it's wrong to see big-business as automatically anti-competitive. Sometimes it's the other way around. One reason manufacturers have held down prices is that their superstore customers—the Wal-Marts and Home Depots—have the purchasing power to insist on low prices.

In truth, the inefficient firm—however big—is its own worst enemy. Its inefficiency curbs its power. Its products become vulnerable to competition; its managers become vulnerable to takeover. . . .

—Robert J. Samuelson, *Washington Post* Writers Group



Analyzing the Issue

1. What is Garten's basic objection to megamergers? How does he support his position?
2. What fundamental forces, in Samuelson's view, curb the power of giant corporations?
3. Explain whose position you agree with, and why, or explain your reasons for a third position.